November 18, 2008

2009 Tax Commission Legislative Package

1. Cigarette Tax Exemption Amendments (2009 FL0439) Section 59-14-204.5(1)(b) refers to cigarettes exempt from tax under Section 5701 of the Internal Revenue Code. This reference is to the imposition of the federal tax on cigarettes. Section 5704 provides exemptions from the tax. The agency recommends making this change to the statute.

2. Amendments to Sales and Use Tax Exemption for Certain Machinery, Equipment, or Parts (2009 FL0440) In the 2006 legislative session, the manufacturing exemption (Section 59-12-104(14)) was revised to remove the requirement that the machinery and equipment be used "in a new and expanding operation in a manufacturing facility **in the state**". While the intent was to remove the new and expanding language, the legislation also removed the language stating that the machinery and equipment be used in a manufacturing facility **in the state**. Note that the language that provides an exemption for normal operating repairs and replacements (59-12-104(14)(a)(ii) and (b)(i)(B)) still contains "in the state" language, thus making the exemption internally inconsistent. Accordingly, a manufacturer with operations in Utah and another state could purchase machinery and equipment for use in the operations outside of Utah and qualify for the exemption, but normal operating repairs and replacements would qualify only if used in the facility in the state. The agency recommends legislation to add back the "in the state" language for machinery and equipment in 59-12-104(14).

3. Amendments to Vehicle Registration Requirements (2009FL 0441) Section 41-1a-508 requires payment of sales tax only prior to titling. However, not all vehicles registered in Utah are titled in Utah. In addition, older off-highway vehicles and boats are not required to be titled under Utah law. Because Utah law only requires sales tax to be paid at the time of titling a vehicle, persons who are not required to have a title for their vehicle, or whose vehicle is titled in another state could avoid Utah sales tax. Accordingly, the agency proposes legislation to require proof of sales tax paid on a first-time registration if no title is present.

4. Withholding Tax Amendments (2009FL 0442) Section 59-10-406(2) requires that a withholding tax return shall accompany each payment of amounts deducted and withheld. Each return shall include:

- the total amount of wages paid to employees;
- the amount of federal income tax deducted and withheld; and
- the amount of Utah withholding tax deducted and withheld.

Section 59-10-407 provides for a monthly withholding return for employers who have an average withholding tax liability that meets an amount designated by the commission in rule. Accordingly, this monthly return should include the same information as the quarterly and annual

returns. Traditionally, this monthly return has been in the form of a payment coupon that includes the Utah tax withheld, but not total wages or federal income tax deducted and withheld. This has been the case for many years.

The agency recommends legislation that would repeal the requirements of total wages and federal income tax deducted and withheld for monthly payment coupons. Quarterly and annual returns will contain all of the statutory requirements. In addition, each monthly filer will file a quarterly return with all of the statutory requirements. The legislation will apply only to the monthly filings that are not made on a calendar quarter.

5. Amendments to Tourism, Recreation, Cultural, Convention, and Airport Facilities Tax Act (2009FL 0444) From its inception, Section 59-12-603 allowed a county to impose a tax of up to 1 percent on sales by a restaurant of prepared food and beverages. Based on this language, the 1 percent tax was imposed on alcoholic beverages sold in a restaurant. In 2007 HB 27, the imposition of the tax was changed from "prepared foods and beverages" to "prepared food" and "food and food ingredients". Because neither prepared food, nor food and food ingredients includes alcoholic beverages, this change would prohibit a restaurant from imposing the 1 percent tax on alcoholic beverages. This change, which occurred on a bill that was prepared by the commission, was inadvertent. Further, the commission believes that restaurants continue to impose the 1 percent tax on alcoholic beverages because of the work it would entail for a restaurant to make this change to its systems. Accordingly, the commission recommends adding "alcoholic beverages" to the list of items the 1 percent tax may be imposed upon.

6. Sales and Use Tax Definitions Relating to Property (2009FL 0446) One of the more complex issues in sales tax is determining whether an item is real property, tangible personal property attached or tangible personal property. This is especially true for home appliances and trade fixtures. These complexities exist for retailers as well as repairmen. For example, a refrigerator would be considered tangible personal property but a built in refrigerator would be real property. A built-in dishwasher in a home would be considered real property but the same built-in dishwasher in a restaurant would be considered a trade fixture and treated as tangible personal property. A clothes washer and dryer would be considered tangible personal property unless they were built in. A microwave could be real property, tangible personal property attached, or tangible personal property depending on how it is installed. For a repairman, all of these variances make it very difficult to collect the right tax. An audit is almost impossible because the auditor is unable to see the item to determine what type of property it is.

The agency recommends legislation that would classify all appliances as tangible personal property regardless of how or whether that appliance is attached to real property. If that were accomplished, a retailer or repairman would not have to consider whether the item would be attached or how it would be attached, or, for example, if a dishwasher were going to be installed in a home or in a restaurant. This change will simplify recordkeeping for retailers and repairmen. In recent discussions the auditing division has had with the industry, the industry has indicated it would welcome this change. This change would not impact plumbers or heating and cooling

contractors. Sinks, water heaters, furnaces and air conditioners will continue to be treated as real property.

7. Sales and Use Tax Amendments (2009FL0447) Section 59-12-103(1)(m) of the current sales tax code imposes sales tax on the purchase of a prepaid telephone calling card. The telecommunications service charged to a prepaid telephone calling card is exempt from sales tax under Section 59-12-104(43). A prepaid telephone calling card is not defined.

Beginning January 1, 2009, the SST term "prepaid calling service" becomes effective. A prepaid calling service is a telecommunications service subject to sales tax if the service originates and terminates within the boundaries of the state. "Prepaid calling service" is defined as a telecommunications service that is paid for in advance, uses an access number or code, and is sold in a predetermined amount that declines with use.

While the code does not define a prepaid telephone calling card, the commission believes a prepaid telephone calling card fits within the definition of a prepaid calling service and, as such, would be subject to tax based on the origination and termination of calls made with that card. This, of course, would be in conflict with the code's treatment of prepaid telephone calling cards as stated above.

For this reason, the commission recommends legislation repealing the current code provisions relating to telephone calling cards. This legislation would have the effect of exempting the purchase of the card from tax (whereas all are now taxable) , and instead, taxing the services provided with the card based on the origination and termination of calls made with the card.

8. Exemptions from Requirements to Deduct and Withhold and Income Tax (2009FL0458)Under Section 59-10-401, an employee is defined as "every individual performing services for an employer, either within or without, or both within and without the state. . ." While in theory, this language arguably requires an employer to withhold Utah tax for an individual who comes from out-of-state to perform services for that employer one day only, in practice employers are more likely to not withhold Utah tax on those employees who are only in the state temporarily.

The commission proposes legislation the state seek legislation that will both clarify and simplify the employer's responsibility for withholding. Under the proposal, an employer is not required to withhold Utah income tax from an employee that:

(1) the employer expects to perform services in the state for less than 20 days in the current tax year; or

(2) performed services in this state for the employer for less than 20 days in the previous tax year; OR

(1) the employer expects will have wages attributable to the state of less than $50,000 in the current tax year; or

(2) had wages attributable to the state of less than $50,000 for the employer for the previous tax year.

It is important to note that his proposal affects only an employer's responsibility to withhold taxes from an employee. It does NOT affect an employee's tax liability.

9. Sales and Use Tax - Determining the Location of Certain Transactions (2009FL0459) Section 59-12-212 provides an exception to destination-based sourcing if an order of tangible personal property is received and delivered in this state. In that case, a seller will source the sale to the seller's business location. Section 59-12-212 further provides, in accordance with the SST agreement, that this exception applies only to sales of tangible personal property, and not services, unless the tangible personal property and the service are sold in the same transaction and on the same invoice.

In preparing to implement this section the commission has become aware that many sellers who provide a service will at times, but not all times, sell tangible personal property with that service. So, a repairman who only cleans out a dryer vent, for example, must source that sale to the location where the service is performed. On the other hand, if that same repairman sells a part for the dryer, the repairman must source that sale to the repairman's business location. To ameliorate this burden on the seller, the commission recommends legislation that will allow the seller of a service to source the sale of a service to the seller's location if the seller sells an item of tangible personal property in any transaction. The commission believes that this recommendation, while a change to SST agreement required language, is nonetheless in substantial compliance with the SST agreement.

10. Reporting of Certain Transactions Exempt from Sales and Use Taxes (2009FL0457) Section 59-12-105 requires a taxpayer to report to the commission the amount of purchases exempt under the manufacturing and semiconductor exemptions. Historically, the compliance with this requirement has been poor. The simplified electronic return (SER) that sellers registered under the SST agreement must be allowed to use does not provide for a reporting of these exemptions. A second page to the SER, which may only be requested at six-month intervals, provides for this reporting. However, due to poor compliance with this provision and the extra work it would require of SER filers, the agency recommends that Section 59-12-105 be repealed.